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No. 09-1417

Supreme Court, U.S.
FILED
JUL 0 - 2010
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

UNITED RENTALS, INCORPORATED,

Petitioner,

v.

JAMES BIGELOW ANGELL,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioner's corporate disclosure statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that statement.

TABLE OF CONTENTS

Page

STATEMENT PURSUANT TO RULE 29.6 ... i

TABLE OF CONTENTS ii

TABLE OF CITED AUTHORITIES iv

REPLY BRIEF FOR THE PETITIONER 1

I. The Fourth Circuit's decision under § 547(b)(5) relating to United Rentals unasserted bond claims conflicts with the decisions of the Sixth Circuit and other circuits. 2

A. The "diminution rule" and the "100% rule" are in direct conflict in this case. 2

B. Deciding § 547(b) based upon a determination made at the time of the transfers conflicts with clear precedent of this Court and the Sixth and Tenth Circuits. 4

Contents

Page

II. The decision below implicates reoccurring issues of national importance. 6

A. United Rentals and other creditors holding inchoate mechanic's liens and payment bond rights at the time of any allegedly preferential transfers are prejudiced by the receipt of those transfers. 6

B. The ordinary course of business defense does not alleviate the prejudice created by the Fourth Circuit's ruling or provide a viable means of protection for creditors with inchoate liens or payment bond rights. 8

C. The Trustee's proposed "contingent bond claim" is not a viable solution. 10

CONCLUSION 11

TABLE OF CITED AUTHORITIES

Page

Cases

Carlson v. Rose (In re Rose), 88 B.R. 193 (Bankr. W.D. Mo. 1988) 6

Marathon Oil Co. v. Flatau, 785 F.2d 1563 (11th Cir. 1986) 8

Neuger v. United States (In re Tenna Corporation), 801 F.2d 819 (6th Cir. 1986) ... 5

Palmer Clay Products v. Brown, 297 U.S. 227 (1936) 2, 3, 4, 5

Pearlman v. Reliance Insurance Company, 297 U.S. 227 (1936) 3

Sloan v. Zions First National Bank (In re Castletons), 990 F.2d 551 (10th Cir. 1993) 5

Yurika Foods Corp. v. U.P.S. (In re Yurika Foods Corp.), 888 F.2d 42 (6th Cir. 1989) 8

Cited Authorities

Page

Statutes

11 U.S.C. § 546(b) (2010) 7, 8

11 U.S.C. § 547 (2010) 2

11 U.S.C. § 547(b) (2010) 4, 5, 7, 11

11 U.S.C. § 547(b)(5) (2010) 2

11 U.S.C. § 547(b)(5)(b) (2010) 7

11 U.S.C. § 547(c)(2) (2010) 8

40 U.S.C. § 3133(b)(4) (2010) 10

N.C. GEN. STAT. 44A-28(b) (2010) 10

REPLY BRIEF FOR THE PETITIONER

Despite acknowledging that diminishment of the estate remains an element of a preferential transfer, the Trustee relies on the "100% rule" and the classification of United Rentals as a "general unsecured creditor" at the time of the transfers as the decisive analysis in this case. This argument merely highlights the flaws in the court of appeals decision. While this "100% rule" may generally apply, the statutory and contract rights possessed by United Rentals render the rule inapplicable when a court is required to consider the actual effect of the transfers on the bankruptcy estate.

The Trustee also presents a number of reasons why the policy implications of the Fourth Circuit's decision should not concern contractors and suppliers throughout the construction industry. While these suggestions may present some protection to these members of the construction industry, they do very little to alleviate the real world impact of this decision. If this decision is allowed to stand, contractors and suppliers risk being denied the protection of mechanic's lien statutes and payment bonds not by the fact that a bankruptcy was filed, but rather by the fact that these contractors or suppliers accepted payment for their work prior to the bankruptcy filing. This Court should grant certiorari to review this inequitable and illogical result and prevent its wide-ranging implications in the construction industry.

I. The Fourth Circuit's decision under § 547(b)(5) relating to United Rentals unasserted bond claims conflicts with the decisions of the Sixth Circuit and other circuits.

A. The "diminution rule" and the "100% rule" are in direct conflict in this case.

The Trustee argues that "[a]lthough the diminishment rule generally applies in determining whether § 547(b)(5) applies, the 100% rule is a special application of that rule applicable to unsecured claims such as the claims of United Rentals in this case." Brief in Opposition p. 19 (hereinafter "Opposition"). The premise underlying this position is that a transfer to a creditor who is determined to be a general unsecured creditor *always* results in a diminishment of the estate unless the bankruptcy estate is sufficient to pay all of the general unsecured creditors in full. While this may be accurate in most bankruptcies, the rights created by mechanic's lien statutes and payment bonds create a situation where this premise fails.

In *Palmer Clay Products v. Brown*, 297 U.S. 227 (1936), this Court numerically analyzed the effect of a transfer on the estate. *Id.* Looking to language from section 60 of the Bankruptcy Act, this Court determined that the hypothetical creditor there would receive "a greater percentage of his debt than any other of such creditors of the same class." *Id.* This quoted language is not a part of the modern Bankruptcy Code. *See* 11 U.S.C. § 547 (2010).

In a chapter 7 liquidation, the estate available for distribution to all creditors is a finite amount. The estate available for distribution to general unsecured creditors

is that finite amount minus the amounts paid to creditors with higher priority claims. Where a creditor has no recourse against the third party, the "diminishment rule" and the "100% rule" reach the same result.

The circumstances presented in the instant case are factually distinct from *Palmer Clay Products*. Had the alleged preferential transfers not been made, United Rentals could have asserted a claim against the payment bonds on the projects between the dates of the transfers and the petition or post petition and been paid by the surety. Per this Court's decision in *Pearlman v. Reliance Insurance Company*, 297 U.S. 227 (1936), the surety would have then had an equitable lien on any funds earned by the debtor on the project and those funds would have never become property of the estate. As a result, the transfers would not have been part of estate if United Rentals had not received them, but rather property of the surety. Because the total value of the estate, the total amount of secured or priority claims and the total amount of unsecured claims remains constant whether the transfer was made or not, the transfer did not diminish the estate available to unsecured creditors. As required by this Court in *Palmer Clay Products*, the *actual effect of the payment as determined when bankruptcy results* in the instant case is that the estate available for distribution to unsecured creditors is identical if United Rentals received the transfers or if it did not.

Consequently, the "100% rule" as applied in this case and advocated by the Trustee, is not a "specific application of the diminishment rule" but rather in direct

conflict with the diminishment rule. As noted extensively in the writ filed in this matter—and conceded by the Trustee in its Brief in Opposition—various circuits hold that diminishment of the estate is an element of § 547(b). None of the lower courts in this case required the Trustee to establish this element or even considered diminution as an element of § 547(b), but rather relied strictly on a classification of United Rentals as an unsecured creditor. For this reason, the Fourth Circuit's decision is in direct conflict with the Sixth Circuit and various other circuits and warrants this Court's review.

B. Deciding § 547(b) based upon a determination made at the time of the transfers conflicts with clear precedent of this Court and the Sixth and Tenth Circuits.

Not only does the application of the 100% rule conflict with the Sixth Circuit and other circuit court precedent identifying diminishment as an element of § 547(b), the analysis underlying the application of this rule in this case directly conflicts with precedent of this Court and the Sixth and Tenth circuits.

As the Trustee notes, in deciding whether the Trustee had met his burden under § 547(b), "the Fourth Circuit treated United Rentals as an unsecured creditor." Opposition p. 19. Also, the Trustee argues, "[t]he Fourth Circuits decision . . . is expressly based on its affirmation . . . that United Rentals was an unsecured creditor when the payments were received." Opposition p. 12. This Court's decision in *Palmer Clay Products* is clear that when determining whether a transfer is preferential, the analysis is performed at the time of

the bankruptcy petition, *not at the time of the transfers*. 297 U.S. at 227. The Sixth and Tenth Circuits also agree that the § 547(b) is to be analyzed as of the date of the petition. *See Sloan v. Zions First National Bank (In re Castletons)*, 990 F.2d 551, 554 (10th Cir. 1993) (holding "the petition date is the relevant date for purposes of the hypothetical creditor test under 547(b)(5)"); *Neuger v. United States (In re Tenna Corporation)*, 801 F.2d 819, 822 (6th Cir. 1986) (stating that the date of the petition is the date "that a payment should be tested").

While this case remains rife with confusion, the case law is clear that identifying United Rentals as an unsecured creditor at the time of the payments is meaningless in applying the required test under § 547(b). If, as the Trustee argues, the 100% rule can act as an exception to the Sixth and other circuits holdings that Trustee must show actual diminishment of the estate to establish § 547(b), the manner which it was applied in this case was in conflict with precedent of this Court and various circuits. Thus, review by this Court is warranted.

II. The decision below implicates reoccurring issues of national importance.

A. United Rentals and other creditors holding inchoate mechanic's liens and payment bond rights at the time of any allegedly preferential transfers are prejudiced by the receipt of those transfers.

In his Statement of the Case, the Trustee argues that "the prejudice of recovery of a preferential payment is no greater than that applicable to a general creditor, including a general unsecured creditor that could have obtained a judgment lien or other lien, but failed to do so." Opposition p. 9. United Rentals received the transfers on June 14, June 30 and July 20. On those dates, no creditor could have obtained a judgment lien against the debtor as the attachment of such a lien within the ninety days prior to the bankruptcy filing would itself be a preference. *See e.g. Carlson v. Rose (In re Rose)*, 88 B.R. 193 (Bankr. W.D. Mo. 1988). Here, in order for a judgment lien to be valid against assets of the debtor, that judgment lien would have had to be attached no later than June 3, 2004. Because the dates of the transfers are well beyond the dates a judgment lien could have attached to assets of the debtor, it is certain that preferential transfers cannot and do not prejudice a potential judgment lien creditor.

In stark contrast, it is undisputed that on the dates of the transfers United Rentals could have perfected its inchoate mechanic's liens or made a claim on the payment bonds. As of the dates of the transfers, United Rentals had neither slept on its remedies nor foregone

the opportunity to pursue those remedies had they not received the transfers. The only events that prevented United Rentals from taking advantage of these remedies were the transfers. Thus, unlike a judgment lien creditor, the prejudice faced by United Rentals was a direct result of the transfers.

This prejudice is most poignant when you consider the impact of the transfers on United Rentals rights under state law. United Rentals last supplied rental equipment on the projects relevant in this case on June 1 and September 22, 2004. As a result, the applicable deadlines under state law and the payment bonds are well beyond when the transfers were received. Under the Fourth Circuit's ruling these deadlines are changed drastically. The Fourth Circuit would require United Rentals to have perfected its liens or made claims against the bonds by the dates the transfers were actually received—June 14, June 30 and July 20—or lose the protection of these statutes and bonds. The modified deadlines created exclusively by the fact that United Rentals received the transfers are prejudicial to United Rentals and, under the Fourth Circuit's opinion, detrimental to their ability to exercise their bond rights or perfect their inchoate liens.

In contrast to this result, § 547(b) demonstrates a clear congressional intent that creditors not be prejudiced by the receipt of a transfer by requiring that the preference analysis be performed as if "the transfer had not been made." *See* 11 U.S.C. § 547(b)(5)(b) (2010). Similarly, § 546(b) demonstrates the congressional intent to protect a creditor, like the holder of an inchoate mechanic's lien, "that acquires rights in such property

before the date of perfection." *See* 11 U.S.C. § 546(b) (2010). Here, the fact that transfers were received was the sole cause of the prejudice faced by United Rentals and United Rentals unquestionably would have been better off had it not received the transfers. This result is both inequitable and inconsistent with the intent of the Bankruptcy Code.

B. The ordinary course of business defense does not alleviate the prejudice created by the Fourth Circuit's ruling or provide a viable means of protection for creditors with inchoate liens or payment bond rights.

The Trustee further asserts that the ordinary course of business defense created by 11 U.S.C. § 547(c)(2) will protect mechanic's lien or bond claimants from being prejudiced by accepting payment. Opposition p. 36. He argues that if a contractor does not receive payments within the "ordinary course" it can then exercise its other remedies. *See* Opposition p. 36 (advocating this Court should not review this case because United Rentals could exercise its lien and bond rights in the future).

The ordinary course of business defense requires a court consider "several factors, including timing, the amount and manner a transaction was paid and the circumstances under which the transfer was made." *Yurika Foods Corp. v. U.P.S. (In re Yurika Foods Corp.)*, 888 F.2d 42, 45 (6th Cir. 1989). Late payments are considered particularly important in this analysis. *Marathon Oil Co. v. Flatau*, 785 F.2d 1563, 1567 (11th Cir. 1986). The Trustee asks that contractors or suppliers

track all of these factors, establish an ordinary course of business for each customer and immediately exercise its mechanic's lien or bond rights when a payment fails to be made within that time period with the hope that its internal analysis will match that of the court.

In this case, United Rentals received payments on June 14, June 30 and July 20 of 2004. These three payments encompassed forty-five invoices related to the projects with thirty-four unique invoice dates ranging from January 3, 2004 until April 13, 2004. Under the system argued by the Trustee, to fully protect itself United Rentals needed to perfect thirty-four liens and make thirty-four bond claims on the date each invoice moved beyond the "ordinary course." The same would be true of every supplier or contractor on any project who wanted to retain the protections created by state statute and payment bonds. Moreover, creditors that are paid earlier than the "ordinary course" are similarly unable to take advantage of this defense. In fact, under the Fourth Circuit's decision the only way for a creditor to be protected is to file a bond claim or perfect a mechanic's lien immediately after credit is extended to ensure that this remedial action precedes payment. Under the Fourth Circuit's opinion, the race to the courthouse to dismember the debtor begins immediately upon the extension of credit and the ordinary course of business defense will do nothing to slow this down.

C. The Trustee's proposed "contingent bond claim" is not a viable solution.

The Trustee's argument that United Rentals could make a "contingent bond claim against the surety for payments made within the preference period" is similarly without validity. This solution does not solve the problem of the sheer volume of bond claims that will be made and the effects of those claims on construction projects and the debtor when sureties make claims on money owed to the debtor in an effort to limit their exposure. These claims by sureties will stop the flow of funds to the debtor on projects, thereby eliminating the debtor's cash flow and accelerating the slide into bankruptcy.

A "contingent bond claim" also does not provide a viable source of recovery "even if the preference payment is avoided." Most payment bonds establish a limitations period for filing suit to enforce a claim against the bond and the surety. The Miller Act requires that a claimant file suit within one year. *See* 40 U.S.C. § 3133(b)(4) (2010). The North Carolina Little Miller Act requires the same thing. *See* N.C. GEN. STAT. 44A-28(b) (2010). This case, like many if not most preference avoidance actions, was filed nearly two years after bankruptcy was filed. By that time, any contingent bond claim would have been rendered useless unless a creditor has also filed a "contingent" lawsuit for sums it had already been paid. Again the Trustee's proposed system inflates legal costs to both creditors and the debtor and results in a race to the courthouse to dismember the debtor.

CONCLUSION

Had it not received the transfers, United Rentals could have enforced its bond rights or perfected its inchoate mechanic's liens either between the dates of the transfers and the petition date or after the petition date. United Rentals would have then been paid in full. The assets available for distribution to general unsecured creditors would be equivalent in either of these circumstances because of contingent secured or rights against estate assets by the general contractors and surety. Consequently, United Rentals is no better off and the estate is no worse off for the prepetition transfer. This is very different from the general unsecured creditor that could have sought a judgment lien prepetition, but elected not to. Indeed, a judgment lien obtained during the preference period could be avoided. Unlike a potential judgment lien creditor, the prejudice faced by United Rentals and other creditors holding inchoate liens or bond rights is a direct result of having received the transfers. Here, the "100% rule" fails to take into account the actual result of the transfers on the estate and conflicts with various circuits that require diminishment of the estate as an element of § 547(b).

Despite the opportunity to point out to this Court why the Fourth Circuit's decision will not cause suppliers and contractors to disrupt construction projects through the filing of mechanic's lien and bond claims, the Trustee has only pointed out why the other defenses available to a supplier or a contractor will further encourage a race to the courthouse and accelerate the debtors slide into bankruptcy or why those defenses fail to protect a

supplier or contractor from exposure. As noted in United Rentals' writ and unsuccessfully rebutted by the Trustee in his brief in opposition, the public policy implications of the Fourth Circuit's decision on the construction industry are dire and far-reaching. This decision conflicts with decisions of this Court and other circuits and threatens to disrupt both public and private projects throughout the country.

Review by this Court is necessary to prevent such inconsistent application of the Bankruptcy Code and the resulting consequences. United Rentals' writ should be granted and the decision of the Fourth Circuit overturned.

Respectfully submitted,

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